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In the Matter of)	
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Madison River Telephone Company, LLC.)	WC Docket No. 02-371
Tariff FCC No. 1)	
Transmittal No. 9)	
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January 8, 2003

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554**

In the Matter of

**Madison River Telephone Company, LLC.
Tariff FCC No. 1
Transmittal No. 9**

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AT&T CORP. OPPOSITION TO DIRECT CASE

Pursuant to the Investigation Order (“*Investigation Order*”) in this matter released on November 25, 2002, by the Chief of the Pricing Policy Division, AT&T Corp. (“AT&T”) hereby submits its Opposition to the Direct Case filed by Madison River Telephone Company (“MRTC”).

I. INTRODUCTION AND SUMMARY

In this proceeding, MRTC seeks to impose an increase of \$424,000 to the component of its traffic sensitive revenue requirement related to uncollectibles, resulting in a rate increase for *all* access customers, not merely those that present serious risks of non-payment. The purported basis for this mid-period modification is that MRTC projects a rise in its uncollectible amounts, based on its claims that it has recently experienced defaults from certain carriers that it has not yet been able to collect.

The fundamental flaw in MRTC’s tariff transmittal is that it seeks to burden *all* access customers with higher rates due to purportedly increased costs that occur, if at all, because of a few carriers that default and are unable to pay for access. In a recent *Policy Statement*, however, the Commission made clear that incumbent LECs may *not* seek to protect against nonpayment risks by implementing new tariff revisions that are not narrowly tailored to

customers that pose a genuine risk of default but instead apply to a broad array of access customers. For this reason alone, MRTC's rate increase must be denied.

In all events, and even if such a broad remedy were appropriate, MRTC has not justified any need for increased rates. Rather, the facts in this proceeding show that MRTC – like other incumbent LECs – enjoys very low levels of bad debt expense, particularly when compared to the monopoly revenues it collects for providing access services. And the evidence here also shows that any recent increases in uncollectibles are due to temporary and non-recurring events, such as the general downturn in the economy and the bankruptcies of WorldCom and Global Crossing, which were apparently triggered by massive accounting fraud. These events provide no basis to expect that *future* uncollectibles will be significantly higher.

MRTC nonetheless has created a “model” that purports to estimate its future uncollectibles and to show that MRTC will incur a much higher level of uncollectibles expense than it has historically experienced. Not surprisingly, MRTC's inflated estimate of future bad debt expense is rife with methodological flaws, and is based on, for example, the MRTC management's subjective (yet undisclosed) assumptions regarding the risk of default for its access customers and the amounts that MRTC will collect in bankruptcy proceedings. Because MRTC has not shown that its future risk of uncollectibles will in fact rise to the extreme levels that it projects, there is no basis for the Commission to allow MRTC's proposed rate increase.

Further, even if MRTC had shown some measurable increase in costs due to risks of future uncollectibles, it plainly has not demonstrated that its proposed increase (or, indeed, any increase) to the revenue requirement is necessary to provide MRTC with its allowed rate of return. To the contrary, MRTC has consistently earned in excess of its 11.25% allowed return.

The reality is that MRTC, like other incumbent LECs, is already adequately protected from non-payment risks by existing tariff provisions that allow MRTC to extract security deposits from carriers that have no established credit or that have a proven history of non-payment. There is, accordingly, no reason to grant MRTC's rate increase or to adopt any other alternative proposal to address non-payment risks. In particular, any proposal to allow advance billing of switched access for *all* customers, without regard to the customer's actual risk of non-payment, would be far too draconian a solution to the problem alleged by MRTC.

II. MRTC's PROPOSED RATE INCREASE IS INCONSISTENT WITH THE COMMISSION'S RECENT *POLICY STATEMENT*.

As an initial matter, MRTC's tariff transmittal should be rejected because it is now flatly inconsistent with the Commission's recent *Policy Statement* providing guidance to incumbent LECs seeking to revise tariffs to gain additional protection against the risks of bad debt expense.¹ In its *Policy Statement*, the Commission addressed a request by Verizon to allow incumbent LECs to gain new and broad authority to impose security deposits and other one-sided credit provisions on captive access customers, recognizing that its *Policy Statement* would affect pending tariff revisions filed by incumbent LECs, including the MRTC transmittal at issue here. See *Policy Statement* ¶¶ 4-5 & n.14. Most relevant for this proceeding, the Commission found that tariffs filed by incumbent LECs seeking to protect against default by access customers must be "narrowly tailored to meet the incumbent LECs' need for additional protection against nonpayment *without* imposing undue burdens on access customers *in general*." *Policy Statement* ¶ 6 (emphasis added). In particular, the Commission stated that it

¹ See *Policy Statement, In the Matter of Verizon Petition for Emergency Declaratory And Other Relief*, WC Docket No. 02-202 (rel. Dec. 23, 2002) ("*Policy Statement*").

would find objectionable tariff revisions that are “broadly drawn” so as to “affect a broad array of access customers, not only those customers that pose a risk of non-payment.” *Id.* ¶ 22.

MRTC’s Transmittal violates this basic principle of the *Policy Statement*, and should therefore be rejected. Although MRTC purports to justify its rate hike by pointing to problems posed by customers that in the future may be unable to pay, its tariff revisions at issue here are not directed at bankrupts or even at deadbeats, but at *all* ratepaying access customers, even those with impeccable credit. Even if MRTC and other incumbent LECs could show truly increased levels of bad debt expense (which, as the Commission found (*id.* ¶ 14) and as explained below, they have not), this transmittal does not represent a limited, specified and reasonable measure to recover the costs of bad debt caused by customers that can be demonstrated, by objective criteria, to present actual and unusual risks of nonpayment. This rate increase proposal openly seeks to require a “broad array of access customers” to pay increased rates, not merely those that pose “a genuine risk of nonpayment.” *Policy Statement* ¶¶ 22, 27. Because MRTC’s general rate increase is not narrowly tailored, but applies to all access customers, the Transmittal violates the *Policy Statement* and must be rejected.

III. MRTC HAS NOT DEMONSTRATED ANY MATERIAL INCREASE IN THE RISK OF UNCOLLECTIBLES.

MRTC claims that its rates should be increased because there is now “marketplace instability,” which has caused MRTC’s provision of access services to be riskier. Direct Case at 8-9. This claim is demonstrably false. MRTC provides *no* evidence that its access service business has become more risky, because the reality is quite different. In fact, MRTC has not demonstrated that its uncollectibles expense – particularly as a ratio of its rapidly increasing access revenues – has risen to unprecedented levels. To the contrary, for MRTC, uncollectibles expense as a percentage of revenues remains remarkably low. MRTC certainly has not shown

that the recent fluctuations in its uncollectibles expenses are especially volatile or the result of some long-term trend, rather than reflective of general economic business cycles. And MRTC's claims of crisis arising from the bankruptcy filings of certain carriers is equally exaggerated: as MRTC's Direct Case makes clear, virtually all of the asserted increases in 2002 bad debt expense relate to the Global Crossing and WorldCom bankruptcies – which are unique and non-recurring events precipitated by allegations of massive accounting fraud designed to fool investors and creditors. Excluding these abnormal events, it is evident that the bankruptcy claims and bad debt expense for MRTC in 2002 are no more significant than in past years. And bad debt expense has had no negative effect on the bottom line for MRTC: the rate of return earned by MRTC carriers over the last few years have been quite stable and at or even above the prescribed rate of return, confirming that MRTC retains monopoly control over access markets and thus faces little risk of eroding revenues.

A. MRTC's Uncollectibles Are Small Relative To Revenues, And Have Not Varied Substantially Over Time.

MRTC's proposed tariff revisions are plainly unsupported because it has not even shown that it is experiencing any significant and sustained increase in its uncollectibles expenses. MRTC's claims (at 8-9) that it faces a significant increase in risk of bad debt expense from interstate access services are simply misleading. In fact, the bad debt levels experienced by MRTC, like those of other dominant LECs, remain very small in comparison to revenues. The Commission's recent finding (*Policy Statement* ¶ 14) that "the risk posed by uncollectibles may not be as great as alleged by certain carriers" applies fully to MRTC. Moreover, as with other incumbent LECs, it is likely that the levels of MRTC's uncollectibles fluctuate from year-to-year, depending on a number of factors, including general economic conditions and the particular LEC's efficiency in collecting bad debts. Any recent increases in

bad debt levels experienced by MRTC reflect business cycle fluctuations and other temporary events, and not any permanent trend that substantially increases the *future* risks of nonpayment.

The principal data that MRTC provides in response to the *Investigation Order's* requests (§ 7) for its uncollectibles levels is a chart that lists the absolute amount of interstate uncollectibles expense for Gallatin River and GulfTel, the two MRTC subsidiaries. Direct Case at 5-6. However, even from MRTC's own data, it is evident that the relevant measure of uncollectibles expense (which is, of course, the *percentage* of revenues that is uncollectible) is quite small. For both subsidiaries, the uncollectible ratio (*i.e.*, interstate uncollectibles divided by interstate revenues) in the years prior to 2002 was far below 1 percent. For Gallatin, which began operation in 1998, it experienced *no* bad debt expense in 1998 or 1999, and in 2000 and 2001, its uncollectible ratio was 0.0030% and 0.0143%, respectively. And for GulfTel – which did not separately report *any* uncollectible expense until 2001, its uncollectible ratio for 2001 was similarly microscopic, at 0.0113%. As these figures confirm, MRTC is not suffering from any bad debt crisis. Its level of uncollectibles is low by any measure.

MRTC claims there is a significant increase in uncollectibles in 2002, but, as MRTC's Direct Case (at 6) concedes, any recent increase in uncollectibles in 2002 for MRTC is due almost entirely to the bankruptcy filings of two or three carriers, and specifically MCI WorldCom and Global Crossing. Apart from these bankruptcies, the amounts of absolute uncollectibles appear to be generally quite small, and virtually microscopic compared to revenues.² Those bankruptcies have been linked to massive and unprecedented instances of

² In all events, even if MRTC were to incur the amounts of uncollectibles in 2002 that it claims in its Direct Case, the uncollectibles ratio for Gallatin and GulfTel in 2002 (assuming constant revenue) would be 2.7% and 3.3%, which still is just a small percentage of MRTC's overall access revenues.

accounting improprieties.³ It would obviously be improper to permit a rate increase that will affect all customers because of such aberrations that are unlikely to be repeated, given the serious tightening of accounting and related regulation by the Securities and Exchange Commission and other regulators. The *Investigation Order* seeks to determine whether MRTC can demand higher rates from remaining *viable* carriers. If anything, the downfall of MCI WorldCom and others should strengthen the remaining viable carriers who will inherit additional customers.⁴

In fact, as with other incumbent LECs, it is entirely expected that MRTC will experience fluctuations in the year-to-year levels of uncollectibles. Such fluctuations are entirely normal and are the result of a variety of factors, such as general economic conditions and MRTC's efficiency at collecting its debts – and thus cannot justify any tariff revisions. And, as described below, these overall levels of bad debt expense have still had no cognizable negative impact on the ability MRTC to earn just and reasonable returns – indeed, MRTC has typically exceeded its authorized rate of return on access services. Because MRTC has not experienced any material change in its uncollectible ratios, there is no need for its proposed rate increase.

³ For these reasons, there is no merit to MRTC's claims (at 8-9) that MCI WorldCom provides a "good example" supporting MRTC's claim that there are no reliable indicators of default. In fact, there are reliable indicators of default, such as past payment history and lack of established credit – which are already incorporated into ILECs' access tariffs.

⁴ Moreover, as described in the declaration of Professor Bradford Cornell that AT&T has previously submitted in other proceedings, the claims made by MRTC regarding bankrupt carriers tend to show that bad debt expense will generally *not* be occurring in the future. See Cornell Decl. ¶¶ 16-17, attached to AT&T Corp. Opposition to Direct Case, WC Docket No. 02-319, *In the Matter of Ameritech Cos., Tariff FCC No. 2, Transmittal No. 1312, et al.* (filed Nov. 14, 2002) ("Cornell SBC Tariff Investigations Dec.").

B. MRTC's "Model" Of Future Uncollectibles Is Unsound.

Given this evidence that uncollectibles remain low, MRTC's request for a mid-period rate increase is, at bottom, based on a "model" that purports to project a rise in uncollectibles in the future. *See* Direct Case at 9. MRTC explained the basis of this model in its initial tariff filing, but the Commission Staff found MRTC's initial explanation to be insufficient, suspended MRTC's transmittal, and directed MRTC to provide additional information about its projections of future uncollectibles.⁵ In its Direct Case, MRTC continues to rely on its initial tariff description and justification (at 9 n.14), provides virtually no new information about its model, and offers no additional explanation to attempt to justify the numerous assumptions underlying this model. As AT&T has explained, MRTC's model relies heavily on MRTC management's subjective "opinions" and on "assumptions" that are entirely undisclosed and that MRTC itself concedes were made on the basis of imperfect information. *See* MRTC D&J at 3-5. For example, MRTC's calculations reflect its management's estimates of the "risk level" of "a bankruptcy filing by *each* of the top seven" access customers and the amounts MRTC might recover from the bankruptcy process. MRTC D&J at 3, 5. As with its initial filing, MRTC has not provided any record evidence to credit these assumptions, which are based on MRTC's "management opinion about each of these carriers' operations." *Id.* at 3. Since MRTC has chosen not to disclose either the substance or basis of its management's opinions, it is impossible for commenters to critique them or for the Commission to evaluate and rely on them. But in light of the Commission's recent findings that "the bad debt problem is not of the magnitude suggested" by some incumbent LECs, *Policy Statement* ¶ 20, it is

⁵ *See* *Madison River Tel. Co. LLC, Tariff FCC No. 1, Transmittal No. 9*, Order, DA-02-2583 (WCB/Pricing, rel. Oct. 8, 2002); *Investigation Order* ¶¶ 7-9.

almost certainly the case that MRTC management's opinions of access customers default risk is significantly inflated.

Likewise, MRTC assumes that it will recover a mere 12 percent of its pre-petition billings (MRTC D&J at 6, Direct Case at 14), but this estimate is based entirely on the WorldCom and Global Crossing bankruptcy cases, which may not be at all representative of future bankruptcies – if they occur at all – for other carriers. The only justification provided for these estimates of recovery in the WorldCom and Global Crossing cases is MRTC's *ipse dixit* claim that they are "reasonable." *Id.* at 14. The Commission, however, recently found that "bankruptcy proceedings are not affecting the incumbent LECs as adversely as claimed." *Policy Statement* ¶ 19. In particular, some carriers have re-organized and paid all of their pre-petition debts relating to access, and in other cases, the bankruptcy courts have taken steps to assure the payment of access services. *Id.* MRTC's "model" considers none of the cases in which carriers re-paid debts. Because the limited information MRTC has disclosed regarding its "model" is so fundamentally flawed, the model provides no basis to credit MRTC's claims that there is a "potential for large uncollectibles." MRTC D&J at 4. The Commission should reject this so-called model as unsound and unsupported.

Notably, MRTC makes no serious effort to defend its model or the assumptions underlying it – indeed, it effectively concedes that there is little foundation to those assumptions, as evidenced by its concession that the "accuracy of these assumptions is not critical." Direct Case at 11. According to MRTC, this is because over time, MRTC will establish a reserve for uncollectible expense, just as NECA proposed in the proceeding on its rate increase. This reserve will be automatically adjusted depending on the actual level of recoveries. *Id.* But that begs the question of whether the increase is necessary at all – the

reserve can only be justified (if at all) only if uncollectibles increase in a significant manner, and MRTC simply has failed to show that such an outcome is likely.

Moreover, as AT&T described in its opposition to the similar NECA proposal to place into escrow all funds from a rate increase,⁶ the Commission should not adopt such any new “reserve” or “escrow” system merely to account for one potential forecast error associated with MRTC’s mid-course correction filing. Forecast errors surely exist in a variety of aspects of MRTC’s forecast, not merely uncollectibles expense. However, in almost all cases, it is expected that these forecast errors will have a limited impact on MRTC’s ability to earn the prescribed rate of return, because MRTC typically will “under-forecast” some aspects of the projections and “over-forecast” others. In fact, if anything, MRTC traditionally has over-forecasted expenses and under-forecasted revenues, which (as described below) has caused MRTC to earn rates of return in excess of the authorized level. In these instances, the Commission has not attempted to isolate the specific line items of revenue or expense that have not been accurately forecasted to determine why MRTC has earned excessive returns. By the same token, there is no reason to isolate the MRTC forecast on uncollectibles, and to provide a special procedure that would apply to mitigate forecasting errors for that line item alone. That procedure not only would add unnecessary administrative expense, but also ignores the fact that a variety of forecasting errors may have been made, which could offset any error in underestimating uncollectible expense. By proposing a special procedure for uncollectibles forecasting errors, MRTC is in effect designing a change in the rate making process that can only benefit MRTC, and never the customers.

⁶ See AT&T Corp. Opp. To Direct Case, *In the Matter of NECA Tariff* FCC No. 5, Transmittal No. 952, at 18-19, WC Docket No. 02-356 (filed Dec. 16, 2002)

Apart from its discredited model, nothing else in MRTC's Direct Case provides a credible and convincing response to the request of the *Investigation Order* to explain the basis for MRTC's belief that "the risk of uncollectible debts has increased permanently," and to show that any change in bad debt is due to "some structural change in the market," and not a mere temporary downturn in "the general economic climate." *Investigation Order* ¶ 9. Although MRTC claims that the financial position of long distance providers has deteriorated recently and that LECs therefore face a "new external environment" (Direct Case at 9), MRTC never shows that these changes are likely to create a permanent shift in its exposure to bad debts.⁷ Because any recent increase in bad debt expense is most likely due to short-term economic factors, there is no basis to credit MRTC's severely inflated estimates that its uncollectibles will continue to increase throughout the test period.

C. The MRTC Transmittal Is Unnecessary To Allow MRTC To Meet Its Rate Of Return.

Even if MRTC could show some measurable increase in its bad debt exposure, that would still be insufficient to justify its revenue requirement increase, because MRTC provides insufficient evidence that it will not collect revenues sufficient to achieve an 11.25% rate of return.

On June 17, 2002, just three months prior to its filing of this Transmittal, MRTC filed its 2002 annual interstate access tariff filing (Transmittal Nos. 7 and 8), which provided supporting information for its projected revenue requirements, demand and traffic sensitive

⁷ MRTC claims (at 8) that there are a number of "trends" that influence uncollectibles expense, but its claims have no merit. With one exception, the trends relate to a possible reduction in access revenues, but a reduction in the *amount* of revenue does not necessarily translate into an inability to *collect* that revenue. MRTC also cites to reduced bond ratings, but as the Commission's recent *Policy Statement* has found (¶ 21), such bond ratings are not necessarily indicative of an inability to pay access services and cannot justify the type of broad and sweeping tariff revisions of the kind that MRTC seeks to impose on *all* access customers.

access rates for the prospective July 1, 2002 through June 30, 2003 tariff period. At that time, MRTC had filed revenue requirements and rates that it claimed would produce a set of rates that would yield precisely an 11.25 % rate of return for the prospective tariff period.⁸ Now, MRTC asserts that its projection of bad debt costs was drastically wrong, and that it must increase rates to ensure that it will achieve a rate of return equal to 11.25 %.

MRTC's entirely unsupported assertion should be rejected. MRTC has consistently earned in excess of 11.25%.⁹ And for the upcoming period, it is likely that the MRTC's traffic sensitive rates will achieve at least an 11.25% rate of return. MRTC's proposal to implement a significant rate increase is all the more arbitrary considering that there is little time remaining in the current monitoring period. Given that short period, the only possible impact of such large rate increases will be to guarantee *further* inflation in its rate of return. Indeed, MRTC has already filed a preliminary FCC Form 492s for 2001 for Gallatin River and Gulf reporting combined interstate earnings of 13.15%.¹⁰ Notwithstanding that fact, MRTC has *not* made any reductions in its rates to flow-through these excess earnings – even though the amount of any reductions would surely be significant and in fact would easily surpass the \$424,000 increase that MRTC currently seeks to implement. Thus, rather than approving tariff changes that allow MRTC to further increase its rates (and its rate of return), MRTC should instead be required to flow-through its prior overearnings by implementing rate reductions.

⁸ See Transmittal No. 7, Part 36 Separation Program, Gallatin River Communications. Prospective Year-Row 110 and Transmittal No. 7, Part 36 Separation Program, Gulf Telephone Company. Prospective Year-Row 110.

⁹ As reported in MRTC's FCC Form 492's for Gallatin River and Gulf (Sept. 28, 2001 & October 1, 2001 respectively), the Companies' reported cumulative overall interstate access returns for 2000 were 11.43% and 11.98%, respectively.

¹⁰ FCC 492, Rate of Return Report, filed March 29, 2002, reports interstate earnings of 11.01% and 16.09% for Gallatin and Gulf, respectively.

D. MRTC Is Adequately Protected From Non-Payment Risks By The Commission's Longstanding Prescription Allowing Security Deposits From Customers With Unusual Risks of Non-Payment.

MRTC's existing tariffs contain longstanding, Commission-prescribed language that allows MRTC (like other incumbent LECs) to collect security deposits from customers with a poor payment history or with no established credit.¹¹ Those provisions have protected MRTC and other incumbent LECs from non-payment risks for over 15 years – in both good and bad economic times – and they remain more than sufficient today. Given that the level of MRTC's interstate uncollectibles was far less than 1 percent in 2001, there is no conceivable need to allow MRTC to increase its rates to account for this same risk.

The reality is that MRTC's existing tariff provisions offer more than sufficient protection against non-payment risks, and no further relief is necessary. To the extent that MRTC's uncollectibles are increasing because of customers' weakened financial condition, those existing provisions provide MRTC with the ability to demand deposits from customers that are not paying in a timely manner. However, MRTC reveals that it currently does not hold a single deposit from any access customer. Direct Case at 14. If the payment ability of access customers has in fact significantly weakened in the manner MRTC describes, then it seems likely that MRTC could be relying more extensively on the existing tariff provisions to protect against non-payment risks by demanding security deposits from carriers with a proven history of nonpayment. Any additional relief at this juncture is speculative and premature.¹²

¹¹ See Memorandum Opinion & Order, *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1168-70 (1984) (“1984 Access Order”).

¹² The Commission's *Investigation Order* (¶ 9) also requested information about the ability of MRTC to adopt alternatives to its rate increase, such as advance billing. However, the Commission's *Policy Statement* makes clear that advance billing should be “triggered only by concrete, objective standards that are narrowly tailored to target only those customers that pose a genuine risk of nonpayment.” *Policy Statement* ¶ 27. The *Policy Statement* correctly limits

IV. CONCLUSION

For the foregoing reasons, MRTC's proposed tariff revisions should be rejected.

Respectfully submitted,

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MRTC's ability to implement such advance billing procedures because, as AT&T has explained, *see* Letter to Marlene Dortch, FCC, from Michael J. Hunseder, counsel for AT&T, WC Docket No. 02-202 (filed December 9, 2002), such a solution is patently overbroad and would require even carriers with impeccable payment records to begin paying for access services at least a month earlier. Advanced billing of switched access service (and other access services billed on the basis of usage) would create a substantial "mismatch" between expense and revenues for interexchange carriers. *Id.* Accordingly, the Commission should reject any approach that supports advance billing for all carriers.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing AT&T Opposition to Direct Case was served the 8th day of January, 2003, on the following:

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